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ARTHUR ANDERSEN & CO.



MISSOURI LOTTERY

FINANCIAL STATEMENTS AS OF
JUNE 30, 1991 AND 1990
TOGETHER WITH AUDITORS' REPORT

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ARTHUR ANDERSEN & Co.

St. Louis, Missouri

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Missouri Lottery Commission:

We have audited the accompanying balance sheets of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1991 and 1990, and the related statements of revenues, expenditures and retained earnings, cash flows and changes in grand prize winners trust account for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Lottery and the Missouri Lottery Grand Prize Winners Trust Account as of June 30, 1991 and 1990, and the results of operations, cash flows and changes in grand prize winners trust account for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 1, the Missouri Lottery retroactively established the Grand Prize Winners Trust Account during 1991.

Arthur Andersen & Co.

St. Louis, Missouri,
October 30, 1991

MISSOURI LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1991 AND 1990

	<u>1991</u>	<u>1990</u>
<u>ASSETS</u>		
CURRENT ASSETS:		
Cash	\$10,768,436	\$18,578,131
Accounts receivable	2,947,939	2,037,543
Instant ticket inventories	76,098	-
Accrued interest and other receivables	21,425	13,150
	-----	-----
Total current assets	13,813,898	20,628,824
PROPERTY AND EQUIPMENT	3,394,825	4,106,805
	-----	-----
Total assets	\$17,208,723	\$24,735,629
	=====	=====
<u>LIABILITIES AND RETAINED EARNINGS</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 2,809,040	\$ 2,020,039
Accrued prize liabilities	7,809,059	6,565,375
Due to General Revenue Fund	5,045,936	6,238,649
Other accrued liabilities	734,257	670,715
	-----	-----
Total current liabilities	16,398,292	15,494,778
OTHER DEFERRED LIABILITIES	810,431	645,372
RETAINED EARNINGS	-	8,595,479
	-----	-----
Total liabilities and retained earnings	\$17,208,723	\$24,735,629
	=====	=====

The accompanying notes are an integral part of these balance sheets.

MISSOURI LOTTERY

STATEMENTS OF REVENUES, EXPENDITURES AND RETAINED EARNINGS

FOR THE YEARS ENDED JUNE 30, 1991 AND 1990

	<u>1991</u>	<u>1990</u>
OPERATING REVENUES:		
Instant ticket sales	\$109,343,213	\$114,533,882
On-line ticket sales	99,707,564	107,053,182
Pull-tab ticket sales	7,190,089	1,780,083
 Total operating revenues	 216,240,866	 223,367,147
OPERATING EXPENDITURES:		
Instant prize expense	60,733,358	62,590,775
On-line prize expense	49,868,807	53,526,591
Pull-tab prize expense	4,680,121	1,157,054
Instant retailer commissions and incentives	6,558,402	6,524,041
On-line retailer commissions and incentives	5,595,959	6,091,749
Pull-tab retailer commissions and incentives	565,334	152,280
Cost of tickets sold	4,670,616	6,153,692
Wages and benefits	5,401,033	5,362,531
Advertising and promotions	8,272,733	7,735,377
Other general and administrative	5,301,770	5,334,401
 Total operating expenditures	 151,648,133	 154,628,491
 Operating revenues over expenditures	 64,592,733	 68,738,656
NONOPERATING REVENUES:		
Interest income	1,493,918	1,800,020
Other	469,301	152,934
 Total nonoperating revenues	 1,963,219	 1,952,954
 Income before transfers	 66,555,952	 70,691,610
TRANSFERS TO GENERAL REVENUE FUND:		
Operating transfers	(66,555,952)	(70,691,610)
Additional legislative transfer	(8,595,479)	-
 Excess of expenditures and transfers over revenues	 (8,595,479)	 -
RETAINED EARNINGS AT BEGINNING OF YEAR	8,595,479	8,595,479
RETAINED EARNINGS AT END OF YEAR	\$ -	\$ 8,595,479

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1991 AND 1990

	<u>1991</u>	<u>1990</u>
CASH FLOWS PROVIDED BY (USED FOR) OPERATING ACTIVITIES:		
Income before transfers	\$66,555,952	\$70,691,610
Adjustments to reconcile income before transfers to net cash used for operating activities-		
Operating transfers	(66,555,952)	(70,691,610)
Legislative transfer	(8,595,479)	-
Depreciation	1,155,882	1,148,076
Grand prizes deferred	12,858,673	9,268,084
Transfers to Grand Prize Winners Trust Account	(12,858,673)	(9,268,084)
Change in assets and liabilities-		
(Increase) decrease in accounts receivable	(910,396)	256,997
(Increase) decrease in accrued interest and other receivables	(8,275)	12,302
Increase in instant ticket inventories	(76,098)	-
Increase in accounts payable and other accrued liabilities	852,543	63,798
Increase in accrued prize liability	1,243,684	2,294,266
Decrease in due to General Revenue Fund	(1,192,713)	(4,229,738)
Increase (decrease) in deferred liabilities	165,059	(78,651)
Net cash used for operating activities	(7,365,793)	(532,950)
CASH FLOWS FROM INVESTING ACTIVITIES- Additions to property and equipment, net of retirements		
Net cash used for investment activities	(443,902)	(159,330)
Net decrease in cash	(443,902)	(159,330)
Net decrease in cash	(7,809,695)	(692,280)
CASH AT BEGINNING OF YEAR	18,578,131	19,270,411
CASH AT END OF YEAR	\$10,768,436	\$18,578,131

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

GRAND PRIZE WINNERS TRUST ACCOUNT

BALANCE SHEETS AS OF JUNE 30

	<u>1991</u>	<u>1990</u>
<u>ASSETS</u>		
INVESTMENTS	\$22,738,540	\$9,464,707
	=====	=====
<u>LIABILITIES</u>		
DEFERRED GRAND PRIZE LIABILITY	\$22,738,540	\$9,464,707
	=====	=====

MISSOURI LOTTERY

STATEMENTS OF CHANGES IN GRAND PRIZE WINNERS TRUST ACCOUNT

FOR THE YEARS ENDED JUNE 30

	<u>1991</u>	<u>1990</u>
TRANSFERS FROM MISSOURI LOTTERY	\$12,858,673	\$9,268,084
INTEREST ACCRETION	1,437,160	196,623
PAYMENTS TO GRAND PRIZE WINNERS	(1,022,000)	-
Net increase	13,273,833	9,464,707
BALANCE AT BEGINNING OF YEAR	9,464,707	-
BALANCE AT END OF YEAR	\$22,738,540	\$9,464,707
	=====	=====

The accompanying notes are an integral part of these statements.

MISSOURI LOTTERY

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1991 AND 1990

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Missouri Lottery (the Lottery) is accounted for as a proprietary type enterprise fund, is a component unit of the State of Missouri and is exempt from income taxes. The financial statements are prepared in accordance with generally accepted accounting principles on the accrual basis of accounting and conform with practices generally followed in the gaming industry.

Revenue Recognition

Sales of instant lottery tickets are made to licensed retail sales outlets with the right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player. Allowances have been established for estimated tickets to be returned by retailers of \$327,000 and \$571,000 at June 30, 1991 and 1990, respectively.

Sales of pull-tab tickets are made to licensed retail sales outlets with no right of return. Ticket sales are recognized upon the sale of tickets to licensed retailers and are valued at the sale price to the player.

Sales of on-line lottery tickets are generated by the semiweekly "LOTTO" and "Missouri Megabucks" ("Lotto*America") and the daily "PICK 3" games. Sales of lottery tickets are made through licensed retail sales outlets via on-line terminals maintained by the retailers. Ticket sales are recognized at the time the player purchases a ticket from the retailer.

Prizes

Expenditures for instant lottery ticket and pull-tab lottery ticket prizes are recorded based upon the unique predetermined prize structure for each game and are accrued as tickets are sold to the retailer.

Expenditures for on-line lottery ticket prizes are recorded based on 50% of on-line lottery ticket sales. The minimum grand prize amount for the semiweekly "LOTTO" game is \$1,000,000. The "LOTTO" grand prize claims are paid in 20 annual installments (see Note 9).

Any prize that remains unclaimed for one year from the date of the on-line game drawing is used to fund future prize pools.

Cash

Cash consists of funds on deposit with the State Treasurer and banks. The cash on deposit with the State Treasurer is pooled with other Missouri State funds and is fully secured by the depository institutions holding the funds.

Retailer Fees

Licensed retailers are charged a fee for the right to sell lottery tickets. Additionally, certain retailers pay an annual fee in lieu of obtaining an insurance bond. Such fees are maintained in a reserve fund to offset uncollectible accounts receivable from retailers. This reserve fund approximated \$425,000 and \$363,000 at June 30, 1991 and 1990, respectively, and is reflected as a reduction of accounts receivable on the accompanying balance sheets.

Ticket Inventories

Instant lottery ticket inventories consist of instant tickets purchased by the Lottery for new games. Inventories are carried at cost using the specific identification method. Tickets are charged to cost of tickets sold during the operational period of the game.

Property and Equipment

Property and equipment are carried at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated life of the related asset. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period.

Due to General Revenue Fund

Under current statutes, all income before operating transfers of the Lottery, as described in the accompanying income statement, accrues to the benefit of the General Revenue Fund. Operating transfers to the General Revenue Fund are made monthly and are based on estimated income before operating transfers. A portion of the liability to the General Revenue Fund equal to the net book value of capital additions after September 1, 1988, is deferred and is not subject to current operating transfers.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to current year presentation.

As of June 30, 1991, the Lottery's financial statements have been retroactively restated to establish the Grand Prize Winners Trust Account. The Trust Account retains the investment securities purchased by the Lottery to fund grand prize installment payments. The investments and liabilities and related changes of this funding account are reflected in separate statements accompanying the Lottery's primary financial statements. The Lottery's financial statements as of June 30, 1990, have been restated to reflect the reclassification of these assets and liabilities in the Trust Account.

2. STATUTORY REQUIREMENTS:

Missouri statutes provide that a minimum of 45% of the money received from the sale of lottery tickets shall be allocated to prizes. The costs of operating the Lottery, including all commissions to retailers, promotional costs, and all other administrative expenditures, are appropriated by the General Assembly of the State of Missouri.

The Lottery receives certain services for no charge from other Missouri state government agencies. Legal and investigative services are provided by the Attorney General's office and the Missouri State Highway Patrol, respectively. The Office of Administration provides certain services to process expenditures and payroll for the Lottery.

3. ADDITIONAL LEGISLATIVE TRANSFERS:

On June 28, 1991, the state legislature required the Lottery to transfer the balance of retained earnings of \$8,595,479 to the General Revenue Fund. The retained earnings balance consisted of untransferred earnings from the first year of operation, June 11, 1985, to June 10, 1986.

4. ON-LINE TICKET SALES:

On-line ticket sales consist of the following:

	<u>1991</u>	<u>1990</u>
LOTTO	\$41,107,439	\$ 49,079,208
Missouri Megabucks (Lotto*America)	34,702,422	38,007,956
PICK 3	23,897,703	19,966,018
	-----	-----
	\$99,707,564	\$107,053,182
	=====	=====

5. PROPERTY AND EQUIPMENT:

Property and equipment consists of the following:

	<u>1991</u>	<u>1990</u>
Land	\$ 184,512	\$ 184,512
Building	2,505,721	2,505,721
Computers and related software	2,212,281	2,090,472
Autos	1,155,971	999,120
Equipment	2,366,851	2,361,353
	-----	-----
	8,425,336	8,141,178
Less- Accumulated depreciation	5,030,511	4,034,373
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	\$3,394,825	\$4,106,805
	=====	=====

6. PENSION PLAN:

The Lottery participates with other state agencies in the Missouri State Employees' Retirement System (MOSERS) plan. The plan is a multiagency defined benefit plan that covers substantially all of the Lottery's employees. The Lottery's contributions to the plan are set annually by MOSERS, and in fiscal 1991 and 1990, were \$424,881 and \$416,434, respectively.

7. LEASES:

The Lottery's regional facilities are held under lease agreements that expire June 30, 1991, with renewal options available for three to five additional one-year periods. Annual rent expense for these facilities totaled \$160,632 and \$143,520 in fiscal 1991 and 1990, respectively.

8. CONTRACTUAL ARRANGEMENTS:

The Lottery maintains contractual arrangements with providers of goods and services critical to the Lottery's operations. Significant contracts include an agreement with the provider of the Lottery's on-line game computer systems and agreements with producers of the Lottery's instant and pull-tab games tickets, among others. The contracts generally run for one year, with one-year renewals available at the option of the Lottery. The contracts require the Lottery to compensate vendors for goods and services that meet stated quality standards.

As of June 30, 1991, the Lottery terminated its contract with General Instruments, Inc. (GI), the provider of the Lottery's on-line game systems. As of July 1, 1991, GTech Corporation has been contracted to provide all on-line game systems hardware, software, services and support. Costs under the GTech contract are anticipated to exceed the costs of similar services provided by GI. In connection with the termination of the contract with GI, the Lottery settled certain disputes with GI over various services provided during the term of the contract. In settlement of the Lottery's claims, GI paid the Lottery approximately \$372,000 in cash, and performed certain additional services primarily related to the conversion to the new on-line games vendor.

The Lottery is a member of the Multi-State Lottery Board (MUSL) that consists of 16 state lotteries and operates the Lotto*America game marketed by the Lottery as Missouri Megabucks. Under separate agreements with each lottery, member lotteries of MUSL sell tickets for MUSL's semiweekly lotto game and remit 45% of sales to prize winners or to MUSL for the payment of prizes. Member lotteries also fund MUSL's operating expenses based on allocations by MUSL. The Lottery has contributed to a prize reserve fund separately maintained by MUSL to protect MUSL members in cases of unforeseen liabilities. The prize reserve fund monies are refundable to MUSL members upon termination of the member's agreement with MUSL or upon disbanding of MUSL. At June 30, 1991, the Lottery's portion of the prize reserve fund totaled approximately \$1,800,000.

9. GRAND PRIZE WINNERS TRUST ACCOUNT:

Prior to March 1990, the Lottery purchased annuity contracts from selected insurance companies to fund "Lotto" grand prize claims. Because it is the intent of the Lottery that the insurance companies make future installment payments directly to each prize winner, neither the value of the annuities nor the value of the related future payments are reflected in the accompanying balance sheets. Future installment payments to be made to grand prize winners by these insurance companies totaled approximately \$108 million at June 30, 1991.

In March 1990, to fund future payments under subsequent prize claims, the Lottery began purchasing U.S. Treasury zero coupon bonds, with maturities approximating deferred grand prize annuity installment amounts and due dates. The securities purchased are held in the Lottery's name in safekeeping by the Federal Reserve Bank in a separate account for the grand prize winners trust account. The investments in these securities are carried at cost, adjusted for the accretion of discounts based on the purchase yield and the maturity date. Discount accreted on these investments is not recognized as revenue of the Lottery but is credited to deferred grand prize liability. These securities are not subject to trading and are intended to be held to maturity. The market value of these securities at June 30, 1991, was approximately \$22,938,000. The maturity value of securities held at June 30, 1991, was \$45,091,000.

Scheduled grand prize installment payments to be funded by the maturing U.S. Treasury zero coupon bonds, as of June 30, 1991, are as follows:

<u>Fiscal Year Ending</u>	<u>Amount</u>
June 30, 1992	\$ 2,427,000
June 30, 1993	2,427,000
June 30, 1994	2,427,000
June 30, 1995	2,427,000
June 30, 1996	2,427,000
Thereafter	32,956,000
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Total installment payments due	45,091,000
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Less- Interest portion	22,352,460
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	\$22,738,540
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